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Professor Roy Green
Queensland Competition Authority
Level 27, 145 Ann Street
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Dear Professor Green

Submission on Aurizon Network Pty Ltd's (Aurizon Network) draft 2017 access undertaking

This submission is provided in response to the Queensland Competition Authority's (QCA) invitation to comment on Aurizon Network's draft 2017 access undertaking (**Draft UT5**). The QCoal Group (**QCoal**) thanks the QCA for the opportunity to provide this submission.

Unless otherwise stated capitalised terms used in this submission have the meaning given to them in the 2016 Access Undertaking (**UT4**).

QCoal is a coal company that actively explores, operates and develops coal resources in Queensland. QCoal currently has three operating mines, Sonoma, Drake and Cows and a large coal project (Byerwen) at an advanced stage of development.

Whilst QCoal is an active member of the Queensland Resource Council's (**QRC**) Rail Working Group and supports the submission of the QRC, it would like to take this opportunity to add comment directly on the Draft UT5.

QCoal acknowledges Aurizon Network's much improved consultation during the lead up to their submission of the Draft UT5, compared with that of UT4.

As per the structure of Aurizon's commentary to its Draft UT5, this submission provides comments on both the policy changes Aurizon Network has proposed and Maximum Allowable Revenue (**MAR**).

Policy

In its submission Aurizon Network has proposed a number of changes to policy matters set out in UT4. As the QCA is well aware, the QCA only approved its Final Decision on UT4 on 11 October 2016, some four (4) months ago. During the UT4 process the QCA and other stakeholders carefully considered each of these policy matters and the QCA's determination was based upon those considerations. Within six (6) weeks of the commencement of UT4, Aurizon Network has proposed changes to a number of the QCA's UT4 determinations. QCoal considers that:

- There has been insufficient time for outcomes of the UT4 policy determinations to manifest themselves and for any conclusion to be obtained as to whether any impacts of those policy determinations that Aurizon Network may be experiencing are simply transitional issues or systematic as a consequence of new policy; and
- Some of the policy matters Aurizon Network has sought to change in the Draft UT5 are matters that Aurizon Network considers the QCA does not have the power to determine. For these matters QCoal relies upon the expertise of QCA to determine the veracity of Aurizon Network's rationale.

QCoal's position on each of Aurizon Network's proposed policy changes is discussed below and summarised in the Table 1.

Relinquishment Process

Aurizon Network has proposed a number of changes regarding relinquishment and resumption of train paths, stating in its submission that the changes proposed are as a result of consultation with customers, will encourage productivity improvement and may provide a better alternative to providing additional capacity than an Expansion. QCoal questions how any customers have actually sought these changes and to what extent.

Whilst QCoal supports and encourages initiatives that encourage efficiency and productivity, and increasing payloads as an alternative to large scale Expansions appears, prima facie to be one option to achieve this, the issue of a "standard" payload is complex.

Train consists with payloads that exceed a system's Train Service Type currently operate in many systems. The introduction of these "non-standard" Train Service Types, which do not align with existing Access Agreements appear to have been driven by above rail Operators seeking to more effectively and efficiently utilise rail systems, whilst potentially reducing costs. These changes appear to have had Aurizon Network's tacit agreement (otherwise their use would have been prevented). QCoal supports seeking to address the existing disconnect between what is actually happening in the network and existing access agreements, and encourage better utilisation of the network. However Aurizon Network's proposed drafting appears to provide it with powers:

- to resume train paths from Access Holders on the basis that with increased payloads, the same tonnage is transported with less train paths; and
- to direct Access Holders and their Operator that payloads must increase;

and these do not appear to align with these objectives.

Whilst considering Aurizon Network's Draft UT5 position on relinquishments, it has become clear that this issue is complex and requires further consideration, by all stakeholders, of all the potential implications of any changes from the current UT4. Some of the issues that QCoal considers need to be more fully investigated and discussed before any changes to UT4 are made include:

- What data will Aurizon Network use to direct that train paths be relinquished? The accuracy of weighbridges in the rail network is frequently questioned and cannot be relied upon.
- The actual tonnage transported from an origin to a destination on a "standard" Train service type varies considerably. This variation may occur due to differences in coal type being transported, the presence of empty wagons in a consist due to a number of reasons, including a train consist having to depart a train load out before being fully loaded.
- Not all Access Holders/ or customers can practically increase payloads due to physical constraints at their train load facility or other physical constraints. Substantial changes to load or other facilities may be required to facilitate the increased load. These changes come at a cost in terms of both resources and time.
- Other than in the case where an increase in payload will create capacity as an alternative to an Expansion and after an assessment of the impact of such a change on all stakeholders is undertaken by an independent third party, should Aurizon Network have the power to direct an increase that will impact above rail Operators, Access Holders and customers? This power appears to go beyond their sphere of responsibility; that is the rail network.

Despite these issues, if above rail Operators and/or specific customers wish to increase payloads, then, so long as there are no adverse impacts on other Access Holders/ customers then there should be a mechanism to enable this to occur, without Access Holders and/or customers incurring increased costs as appears to be the case with the current arrangements.

Given the complexity of this issue, QCoal's view is that the current UT4 provisions should continue to apply but this issue should be further discussed by all stakeholders so that appropriate changes, that can be supported by all or the majority of stakeholders, can be developed and implemented at a later stage potentially through a Draft Amending Access Undertaking.

Negotiated Access Conditions

Aurizon Network has sought to both narrow the definition of Access Conditions and limit the QCA's power to not approve an Access Condition. Aurizon Network's rationale for the change appears to be that under UT4 any change, no matter whether it is material or not, must be approved, and that the UT4 provision affords the QCA powers to approve or not approve that go beyond their powers under the QCA Act.

QCoal's view is that the QCA's ability to review proposed Access Conditions should not be hindered; regulatory oversight of Access Conditions is key to affording Access Seekers some degree of protection against Aurizon Network's monopoly position as the below rail service provider.

QCoal however does support that only “material” matters, as per the QRC submission, need be reviewed by the QCA.

QCoal therefore does not support the changes proposed by Aurizon Network in their Draft UT5.

Aurizon Network’s Right to fund

In its Draft UT5 submission Aurizon Network has proposed changes to provide it with the first right to fund Expansions where it is willing to fund at the regulatory rate. Aurizon Network’s reasoning is that the current UT4 provisions are inconsistent with the QCA Act and override Aurizon Network’s right to invest in its own network.

QCoal does not support providing Aurizon Network with the first right to fund. If this right were provided them QCoal believes it is providing Aurizon Network with a competitive advantage by providing it with opportunities to invest that are not afforded to other investors. The new SUFA provisions have effectively created a market (albeit limited) for funding of rail infrastructure. Without a (relatively) level funding playing field a market where all potentially funders are afforded the same opportunities, the market will not develop and Aurizon Network’s primary position as funder will be reinforced, affording it a significant commercial advantage. The privilege of first right to fund cannot be provided without a corresponding obligation to fund.

Capacity shortfall rectification

In its Draft UT5 Aurizon Network has proposed that it not have an obligation to bear the cost of rectifying any capacity shortfall in respect of an Expansion. Aurizon Network has argued that the QCA exceeded its powers when imposing those provisions in UT4.

QCoal opposes the changes proposed in the Draft UT5 and recommends the UT4 provisions remain because:

- If Aurizon Network undertakes an Expansion that it funds, designs, constructs and enters into contracts with Access Seekers for a certain capacity resulting from that Expansion, then it should be liable for any capacity shortfall, just as any other service provider would be in any other industry.
- When Aurizon Network enters into contracts with Access Seekers, it currently prices into its agreements risks that it perceives are associated with the Expansion. Aurizon Network, as it has control over funding, design and construction should not transfer the capacity risk to Access Seekers where it has such control. Access Seekers have no control over these aspects and have no way of assessing or mitigating this risk, whereas Aurizon Network has.
- Under the provisions of UT4 Aurizon Network, should it fund and construct any new Expansion, will be aware that they must bear any shortfall risk and will consider this in any decision it makes, as it currently does for all other risks. Alternative funders would also need to consider this risk should they propose to fund any Expansion. This is simply the operation of a competitive market. Access

Seekers should not be made to bear this risk when, in any other construction project, the contractor would be bound to deliver the product/ service contracted, and if it is not delivered would either need to rectify or compensate the client.

Supply Chain Coordination

In its Draft UT5 Aurizon Network is proposing two changes to UT4 regarding its interaction with Supply Chain Groups (SCG), firstly that its participation in these groups is not mandatory but on a reasonableness basis, and secondly that it adopt any operational changes determined by the SCG.

QCoal supports Aurizon Network's proposed Draft UT5 on the basis that:

- Aurizon Network has shown a willingness to be an active member of these SCG in the past and it is in their interest to do so; and
- Any operational changes proposed by SCG need to be considered in the context of the whole central Queensland rail network and Aurizon Network is in that unique position and it could be argued is best placed to consider and assess the impact of any operational changes determined by the SCG.

Dispute Resolution process

In its Draft UT5 Aurizon Network has proposed a number of changes to UT4 dispute resolution regime which have the effect of limiting the parties that may raise a dispute, the matters that may be disputed and the experts' field of reference.

Whilst QCoal supports measures that aim to limit the ability to dispute to only those with a genuine, bona fide interest, any other changes to the UT4 dispute resolution process are not supported. A robust and fair dispute resolution process is essential in any relationship where there is an imbalance of information and power, and the Draft UT5 proposed by Aurizon Network does not provide for a fair and equitable mechanism to enable genuine disputes to be aired.

Capacity Review

The Draft UT5 proposes a number of changes to amend the provisions of UT4 regarding capacity assessments. QCoal understands that one of the purposes for the introduction of the capacity review was to address a clear need from Access Holders and Access Seekers alike to understand the actual capacity of each system in the Central Queensland Rail Network. It is with this information that Access Seekers may consider their future development plans, and for Access Holders to understand the "actual" capacity that they have contracted in order to plan their operations. A capacity assessment also allows for the transfer of information as to the inputs and how, at a high level Aurizon Network determines capacity in an individual system. It is clear from Aurizon Network's draft capacity assessment that there are discrepancies between the way Aurizon Network calculates capacity and actual capacity in any rail system, and indeed the assumptions that are used in day-to-day rail network operations. The underlying purpose of the capacity assessment is that it is information that may be used by stakeholders to assess

options, and for this reason it should provide the “best” information possible. For this reason QCoal cannot support many of the changes proposed by Aurizon Network in its Draft UT5. The scope of the role of the expert as set out in UT4, has the potential to improve the quality of the information from a capacity assessment by considering the way in which the assessment is conducted, and for Aurizon Network to consider changes in light of the expert’s findings with a view to refining and improving the output.

QCoal believes that the Draft UT5 changes Aurizon Network has proposed do not move the capacity assessments towards improving the process as QCoal believes was intended by the expert review set out in UT4. QCoal therefore does not support the changes proposed in the Draft UT5 however, QCoal would support changes to UT4 in UT5 that improve the quality of the output from the capacity assessment, and therefore its usefulness, such as those proposed by the QRC.

QCoal’s position on Aurizon Network’s Draft UT5 are summarised in Table 1 below:

Policy Matter	Aurizon Network Change	QCoal Comment
Relinquishment and resumption processes	To allow relinquishments without payment of a relinquishment fee and provide AN with the right to direct a payload increase	Reject Draft UT5 proposal but support development of new provisions to be implemented potentially through a DAAU process.
Negotiated Access Conditions	QCA Approval of Access considerations is limited	Reject Draft UT5 proposal but support restricting to only “material” issues, as identified by Access Seekers.
Aurizon Networks right to fund	Allow Aurizon Network first option to fund at WACC	Reject Draft UT5 proposal
Treatment of capacity shortfalls	Removing the requirement for Aurizon Network to fund capacity shortfalls	Reject Draft UT5 proposal
Supply Chain coordination	Remove requirement for Aurizon Network to implement operational changes suggested by Supply Chain Groups	Agree with Draft UT5 proposal
Dispute resolution provisions	Limit the matters that Access Holders/ Seekers may dispute.	Reject Draft UT5 proposal
Standard User Finding Template		No comment
Capacity review process	Change the experts scope	Reject Draft UT5 proposal
Treatment of asset disposals	Change value of adjustment to the RAB	No comment

Table 1: Summary of QCoal response to Draft UT5 policy changes

Maximum Allowable Revenue (MAR)

QCoal's comments on MAR are limited to general statements on approach and principle as it considers that many of the individual components that comprise the building blocks for the MAR are best dealt with by experts in their respective fields.

Weighted Average Cost of Capital (WACC)

In its Draft UT5 Aurizon Network has sought to make a number of changes to both the values and calculation methodology of a number of fundamental parameters, in particular the asset beta, market and debt risk premiums, gamma and inflation, all of which move to raise WACC.

Given the recent finalisation of UT4 with its considerable expert scrutiny over a long period of time, and that fact that there has been no substantial change in the underlying circumstances used to calculate the parameters, QCoal is of the view that only time dependent parameters, such as the risk-free rate and debt-risk premium should change from that approved as part of UT4.

Maintenance Costs

The lack of specific, system based information on maintenance costs and scope of works in the Draft UT5 is disappointing and makes it difficult for any stakeholder to provide meaningful responses.

Although specific comments on the value of maintenance of various systems is not possible due to lack of information, QCoal has the following general comments:

- One would consider that benchmark, macro approaches to developing a maintenance budget should only be applied to new “systems” such as Goonyella to Abbot Point Expansion with great scrutiny as these systems will not have the same maintenance requirements as older systems, especially where they are not being fully utilised. A micro, bottom up approach to maintenance activities over a top down macro approach has appeal. As more Expansions are completed, a review of the approach to the pricing of maintenance of these new systems should be undertaken to ensure that an appropriate approach to preparing a maintenance scope of works and budget is taken.
- Unlike considerations of both policy and WACC the development of a detailed maintenance and operations budget and scope is (should be) undertaken by Aurizon Network for each undertaking period as the work to be undertaken during that is unique and there is no reason why the scope of works (and budget) for one period simply reflects that of the previous period and costs escalated.
- As QCoal commented on its UT4 submissions, QCoal is also concerned that the efficiency of maintenance activities is not more thoroughly tested. Aurizon Network has stated it believes that changes it has implemented over recent years, has improved the efficiency of their maintenance tasks, however little evidence, in the form of reduced costs is evidenced in the Draft UT5.

Operating Costs

Similar to the comments above regarding maintenance costs, the lack of detailed costs makes it difficult for meaningful comment, and QCoal relies upon the QCA to make comment and determinations with respect to Aurizon Network's operating costs.

Summary

Policy changes

Aurizon Network's Draft UT5 proposes a number of, in some cases substantial, changes to UT4 which has only been recently finalised. QCoal supports those policy changes that simply clarify or set out processes more clearly however, given the recent approval of UT4 and that no substantive changes or disruptions in the economy, or stakeholders' environments has occurred, the changes in the Draft UT5 are generally not supported by QCoal.

Many of the policy changes blatantly improve Aurizon Network's position relative to UT4 often with little justification other than that it believes that the QCA exceeded its powers in many of its UT4 determinations.

Maximum Allowable Revenue

With respect to the changes to the values, (other than those that simply change with time) and methodology of many of the WACC parameters QCoal similarly does not support the approach taken by Aurizon Network given the recent finalisation of UT4.

The lack of information on Aurizon Network's maintenance and operating costs is cause for concern. Stakeholders are not in a position to be able to provide detailed and meaningful comments on this other than general statements, which is lamentable given these form a substantial component of Aurizon Network's MAR.

Yours sincerely

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